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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 271

In the Matter of

620 CHURCH STREET BUILDING CORPORATION, a corporation, Debtor under Section 77B of the Bankruptcy Act as Amended.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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IN THE

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No.

In the Matter of

620 CHURCH STREET BUILDING CORPORATION, a corporation, Debtor under Section 77B of the Bankruptcy Act as Amended.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable, the Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioners, 620 Church Street Building Corporation, a corporation, Irene Goodman, G. Walter, M. Long, A. W. Kibby, Emil Rosenthal and B. K. Goodman, respectfully pray that a Writ of Certiorari issue to review an order entered May 11, 1936, by the United States Circuit Court of Appeals for the Seventh Circuit, denying petitioners' application for leave to appeal from an order

of the United States District Court, for the Northern District of Illinois, Eastern Division (Barnes, D. J.), entered March 31, 1936, confirming a plan of reorganization in proceedings under Section 77B of the Bankruptcy Act as Amended.

The plan of reorganization was so approved by said District Court without the consent and over the objections of the holders of all of the second and third mortgage indebtedness, and of all of the owners of the capital stock of the Debtor, and over the objection of the Debtor, all being petitioners herein, disregarding substantive property rights of certain of your petitioners and eliminating them from all of the benefits of the reorganization.

Summary Statement of the Case.

Respective Interests of Petitioners.

Petitioner, 620 Church Street Building Corporation, is the owner of the property involved in the proceedings. Petitioners, Irene Goodman, G. Walter, M. Long and A. W. Kibby own all the capital stock of the 620 Church Street Building Corporation. Petitioner, Emil Rosenthal, is the owner of the second mortgage on the property, and petitioner, B. K. Goodman, is the owner of the third mortgage on the property.

The Facts.

On July 12, 1934, the 620 Church Street Building Corporation (hereinafter referred to as Debtor) filed its voluntary petition in the District Court of the United States, Northern District of Illinois, Eastern Division, (Case No. 56564) for reorganization under Section 77B of the Bankruptcy Act.

Thereafter, claims were filed, allowed and classified in said proceedings as follows:

CLASS 2.	First mortgage 6% bonds secured by trust deed dated June 30, 1928, principal amount (interest from January 1, 1931 not being included)	$445,500
CLASS 3.	Second mortgage notes secured by trust deed dated July 13, 1928, principal amount (interest from December 13, 1929, not being included)	40,250
CLASS 4.	Third mortgage note secured by trust deed dated June 3, 1931, principal amount (interest from December 3, 1931 not being included)	27,000
CLASS 5.	Common Stock without par value	1,260 shares

Various appraisals of Debtor's property, ranging from $205,000 to $600,000 were submitted to the District Court.

On or about January 30, 1936, a committee representing first mortgage bondholders filed a plan of reorganization of the Debtor, which provides, in brief, that the property of the Debtor be conveyed to a corporation, also under reorganization under Section 77B, which owns a building adjoining the property of the Debtor, and which has distinct and separate stockholders and creditors. The plan provides that such grantee corporation, in consideration of the conveyance of Debtor's property shall issue a part of its first mortgage bonds and stock to be distributed solely among the holders of the first mortgage bonds of the

Debtor. No payment or consideration of any kind to the holders of the second mortgage, to the holders of the third mortgage, or to the stockholders of the Debtor is contemplated. It does not provide for a public sale of Debtor's property, and makes no provision whereby the holders of the second mortgage, third mortgage or stockholders of the Debtor may bid for the property. Furthermore, it does not provide and, in fact, wipes out, the right of redemption of Debtor's property by any of the petitioners.

The plan was accepted by the Committee in behalf of the holders of more than two-thirds of the first mortgage bonds, but no acceptance of the plan was filed by the holders of any of the claims based upon the second mortgage notes, or the third mortgage note, nor by any of the stockholders of the Debtor, all of whom filed objections to said plan.

On the 31st day of March, 1936, the District Court entered an order of confirmation (R. 12) from which leave to appeal was sought in the United States Circuit Court of Appeals for the Seventh Circuit. The order of confirmation finds, among other things, that the property of the Debtor has a fair market value of $245,025, that, therefore, there is no equity in said estate over and above the $445,500 of principal amount of first mortgage bonds, that the Debtor is accordingly insolvent, and that the consent of a majority of the stockholders of the Debtor is not a prerequisite to the confirmation of the plan (R. 14, 15). Said order, in paragraph 12 thereof, purports to appraise all claims filed in Class 3, (the second mortgage notes), and all claims filed in Class 4, (the third mortgage note), to be of no value, and that, therefore, the consents of two-thirds in amount of claims allowed in Classes 3 and 4 were not prerequisite to the confirmation of the plan.

Thereafter, petitioners filed a joint petition for leave to appeal from said order of confirmation, and likewise filed a joint assignment of errors. On May 11th, 1936, the Circuit Court of Appeals denied petitioners leave to appeal.

Questions Presented.

The questions accordingly presented by this application are as follows:

(1) Does Section 77B of the Bankruptcy Act authorize the District Court to approve a plan of reorganization which has not received the consent of two-thirds of each class of claims secured by junior liens, and which does not provide adequate protection for the payment of such claims?

(2) Are the rights of owners of junior liens acquired prior to the enactment of Section 77B of the Bankruptcy Act as Amended, including (a) the right to have the property subject to the junior liens sold at a public sale, and (b) the right to bid at such sale, and (c) the right to make redemption from a sale at the bid price in accordance with the Statutes of the State of Illinois, property rights, within the purview of the Fifth Amendment of the Constitution of the United States, of which the owners may not be divested without their consent?

Reasons Relied Upon for Allowance of the Writ.

The reasons respectfully presented for the allowance of the Writ of Certiorari in the instant case, are as follows:

1. **The conflict between the decision of the District Court which the Circuit Court of Appeals declined to review, and the decision of the Supreme Court of the United States.**

The ruling of the Circuit Court of Appeals is in conflict with the recent decision of this Court involving the same substantive rights. (*Louisville Joint Stock Land Bank* v. *Radford,* 295 U. S. 555)

2. **Conflict in the decision of the Circuit Courts of Appeal.**

The refusal of the Circuit Court of Appeals to grant petitioners leave to appeal and the memorandum filed by the Court (R. 21), conflicts with the decision of the Sixth Circuit (*In Re*: *Tennessee Publishing Co.,* 81 Fed. 2nd 463), and also conflicts with the decision of the Second Circuit (*In re*: *Murel Holding Corporation,* 75 Fed. 2nd 941), and is also in conflict in some respects with its own recent decision (*In re*: *Georgian Hotel Corporation, Debtor,* 82 Fed. 917).

3. **Failure to observe and follow local and Federal law affording protection of property rights.**

Both the law of the State of Illinois and the Federal law recognize that the right of redemption of lien holders is a right in specific property, which cannot be taken away by subsequently enacted legislation in violation of the Fifth Amendment to the Constitution of the United States, (*Louisville Joint Stock Land Bank* v. *Radford,* 295 U. S. 555; *Parker* v. *Dacres,* 130 U. S. 43; *Bronson* v. *Kinzie,* 1 Howard 311; *Fitch* v. *Wetherbee,* 110 Ill. 475, 492; *Buszin* v. *Martinowica,* 178 Ill. App. 519, 523).

4. Importance of the questions involved.

Uncertainty as to the meaning of a law as important in economic affairs as Section 77B should be removed by decision as rapidly as possible, and it is respectfully submitted, when such a case is presented squarely raising significant issues, it is advisable that this court give to the bar and to the public the benefit of its considered judgment.

Considerations of practical justice recommend that the prayer of the petition for Writ of Certiorari be allowed. Numerous cases involving junior liens are pending in the District Court, and their disposition will be facilitated by a decision of this Court. If petitioners be compelled to await final decree in the proceedings below, and then appeal as of right to the Circuit Court of Appeals for the Seventh Circuit, (which Court already by its memorandum filed below (R. 21) indicated that it will decide the merits of the proceeding contrary to petitioners' contentions), much time will elapse during which steps will be taken affecting the title to the property of Debtor, and a substantial sum expended to put the plan of reorganization into effect.

WHEREFORE, your petitioners respectfully pray that a Writ of Certiorari issue out of and under the seal of this Honorable Court to review the decree of the Circuit Court of Appeals for the Seventh Circuit and review the decree of the District Court, and that said decrees of said courts may be reversed.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No.

In the Matter of

620 CHURCH STREET BUILDING CORPORATION, a corporation, Debtor under Section 77B of the Bankruptcy Act as Amended.

BRIEF IN SUPPORT OF PETITION FOR THE WRIT OF CERTIORARI.

STATEMENT.

A.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended; United States Code, Title 28, Section 347.

B.

The Statute Involved.

The statute involved is Section 77B of the Bankruptcy Act as amended. United States Code, Title 11, Section 207. Petitioners seek a construction of paragraph b of Section 77B, the provisions of which pertinent to this inquiry are as follows:

> "A plan of reorganization within the meaning of this Section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise;
> * * *
>
> (5) Shall provide in respect of each class of creditors of which less than two-thirds in amount shall accept such plan (unless the claims of such class of creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens is dealt with by the plan, either as provided in the plan
>
> (a) By the transfer or sale of such property subject to such interests, claims, or liens or by the retention of such property by the debtor subject to such interests, claims, or liens, or
>
> (b) By a sale free of such interests, claims, or liens at not less than a fair upset price and the transfer of such interests, claims, or liens to the proceeds of such sale; or

(c) By appraisal and payment either in cash of the value either of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted; or

(d) By such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."

C.

Judgment Sought to be Reviewed.

The Circuit Court of Appeals for the Seventh Circuit denied petitioners' application for leave to appeal on May 11, 1936 (R. 22), and on June 26, 1936 denied petitioners' motion for reconsideration of said petition for leave to appeal (R. 24).

The order sought to be reviewed in the Circuit Court of Appeals is an order of confirmation of the District Court of the United States approving and confirming a plan of reorganization under Section 77-B of the Bankruptcy Act, entered by said District Court March 31, 1936.

In connection with the order denying leave to appeal the Circuit Court of Appeals filed a memorandum (R. 21) in which said court stated that the District Court did not err in ruling that if the property involved were not worth the amount of the first mortgage indebtedness, the junior interests had no equity to be protected, thus treating the interests of petitioners as possessing a temporary, monetary value alone, based upon opinion evidence, and disregarding petitioners' substantive rights to require a public sale, to be permitted to bid thereat and to redeem from such sale.

D.

Statement of the Nature of the Case.

A petition for the reorganization of the debtor corporation was filed pursuant to Section 77-B of the Bankruptcy Act, as amended, the property of the debtor consisting of a store and office building located in the City of Evanston, in the State of Illinois. The plan of reorganization as confirmed requires the debtor to convey its property to the corporation owning the adjoining premises, the grantee corporation being a distinct legal entity with its own stockholders and creditors. In consideration for the conveyance the grantee is to issue its bonds and some common stock, all of which will go to the holders of the first mortgage bonds of the debtor. The debtor, the debtor's stockholders and the holders of all of its second and third mortgage indebtedness will receive nothing. The District Court, upon opinion evidence, found that the value of the debtor's property was less than the amount of the first mortgage encumbrance and that, therefore, the claims of the holders of the second and third mortgage indebtedness were of no value, there being no equity for them in the property, and that, accordingly, nothing of value should be distributed to them. The order provided, further, that the consent of the petitioners here who hold all of the second and third mortgage indebtedness was not prerequisite to the confirmation of the plan (R. 15). The court found that the plan provides adequate protection for the realization by the holders of the second and third mortgage indebtedness under the circumstances of the case, such claims being of no value (R. 15).

Petitioners contended that their rights did not depend upon their immediate or temporary ability to collect in

terms of money and that the plan disregarded and violated the right to require a judicial sale, to bid at such sale and to redeem in the event that the property was struck off to some other bidder. These rights the District Court disregarded and, thereupon, petitioners prayed for leave to appeal to the United States Circuit Court of Appeals for the Seventh Circuit where petitioners contended that a review of the order of the District Court was necessary to determine the question as to whether or not Section 77-B of the Bankruptcy Act authorizes plans of reorganization under the circumstances of the case. The Circuit Court of Appeals declined to review and, therefore, petitioners present this application for the writ of certiorari.

To avoid needless repetition the court is respectfully referred to the fuller statement of the case contained in the petition for the Writ of Certiorari with which this brief is filed (*ante* page 2).

E.

Specification of Errors.

1. The courts below erred in holding that the approval of a plan of reorganization by the District Court may be ordered without the consent of two-thirds of the holders of recognized classes of claims secured by junior encumbrances, without compensation to them and without making provision for their protection.

2. The courts below further erred in refusing to hold that the rights of junior lien holders, acquired prior to the enactment of Section 77-B, including the right to insist upon a public sale, the right to bid thereat and the right to redeem within fifteen months after a sale to a successful bidder are, under the law of Illinois, property rights which cannot be disregarded or destroyed without consent.

SUMMARY OF THE ARGUMENT.

I.

The approval of the plan of reorganization by the District Court without the consent of the holders of two-thirds in amount of secured junior indebtednesses, without compensation to them and without making provision for their protection, violates the provisions of Section 77-B of the Bankruptcy Act, as amended.

A

Section 77-B requires the consent of two-thirds of any recognized class of creditors to a proposed plan of reorganization unless their claims are not affected or unless the plan makes provision for payment to them in full or unless the plan makes other adequate protection for the realization of the value of their interests, if such interests be affected. The methods for assuring such adequate protection are described in the Act itself, none of which methods was adopted by the plan.

Section 77-B of the Bankruptcy Act as amended, United States Code, Title 11, Section 207, paragraph b.

B

That the rights of classes of creditors must be so protected in the absence of the required consent, is recognized by the decided cases.

In re Hotel Charles Co., 12 Fed. Supp. 734, 736 (D. C. Mass.);

In Re Murel Holding Corp., 75 Fed. (2nd) 941, 942 (C. C. A. 2nd);

Francisco Building Corporation, Ltd. v. *Battson*, 83 Fed. (2nd) 93, (C. C. A. 9th);

Tennessee Publishing Co. v. *American National Bank*, 81 Fed. (2nd) 463, 468, (C. C. A. 6th);

Louisville Joint Stock Land Bank v. *Radford*, 295 U. S. 555, 589, 590.

C

The true value of property in a reorganization proceeding is not a foreclosure, or forced sale value, reorganization contemplating not a present liquidation but a continuance of life into the future.

Warner Brothers Pictures v. *Lawton-Byrnes-Bruner Ins. Agency*, 79 Fed. (2nd) 804, 817, (C. C. A. 8th).

D

The present or immediate collectibility of a claim is not the true or full measure of a claimant's rights and interests.

E

If the value of the property be as low as the amount found by the court then, it may be immediately seen, a public judicial sale would permit petitioners to bid within the same low range of prices and would afford them an opportunity to redeem, within fifteen months, by payment of the amount successfully offered at the sale. It is thus apparent that the value of petitioners' interests cannot be determined by a present appraisal of the debtor's property upon the theory of a liquidation price at a forced sale.

II.

The rights of junior lien holders acquired prior to the enactment of Section 77-B, including the right to insist upon a public, judicial sale, the right to bid at such sale, and the right to redeem within fifteen months after a sale to a successful bidder are, under the law of the State of Illinois, property rights which cannot be disregarded or destroyed without consent.

A

This court has held that no Bankruptcy Act may undertake to destroy the substantive and previously acquired rights of creditors.

Louisville Joint Stock Land Bank v. *Radford*, 295 U. S. 555, 589.

B

This court has also held that in order to determine what are substantive property rights, recourse must be had to the law of the State where the litigation is pending.

Louisville Joint Stock Land Bank v. *Radford*, 295 U. S. 555, 590.

C

Under the Law of Illinois, the mortgagor possesses the right to redeem for the period of twelve months, and a judgment creditor for the period of fifteen months, after sale.

Cahill's Illinois Revised Statutes, 1931, Ch. 77, paragraphs 18 and 20.

D

This court has held that the right of redemption as conferred by a state statute is a rule of property and is a substantive property right.

Brine v. *The Hartford Fire Insurance Co.*, 96 U. S. 627, 634, 636;
Parker v. *Dacres*, 130 U. S. 43, 48;
Bronson v. *Kinzie*, 1 How. 311, 315.

E

The courts of Illinois recognize the absolute nature of the right of redemption.

Fitch v. *Wetherbee*, 110 Ill. 475, 492;
Buszin v. *Martinowicz*, 178 Ill. App. 519, 523;
In Re Georgian Hotel Corporation, 82 Fed. (2nd) 917, 920.

F

Because the right of redemption is a substantive right constituting a rule of property in Illinois, the attempted destruction of that right in the approval of the plan of reorganization is clearly erroneous.

ARGUMENT.

I.

The approval of the plan of reorganization by the District Court without the consent of the holders of two-thirds in amount of secured junior indebtednesses, without compensation to them and without making provision for their protection, violates the provisions of Section 77B of the Bankruptcy Act, as amended.

For the purposes of this application, under the theory that the greater must include the smaller, only the rights of petitioners who hold all of the evidences of the second and third mortgage indebtednesses of the debtor, will be treated.

There can be no question that those of the petitioners who hold all of the second and third mortgage indebtedness and whose claims were classified and allowed as valid, are invested with all of the rights inherent in their respective contracts,—rights which are specifically recognized by the laws of the State of Illinois. The District Court, however, finding that the temporary value of the Debtor's property, from a present sale standpoint, did not equal the amount of the first mortgage indebtedness, proceeded to eliminate these secured creditors from consideration and, without their consent and over their objection, approved the plan which provides for the conveyance of the Debtor's property to the corporation which owns the adjoining structure, in consideration of the delivery of bonds and stock to be issued by the grantee corporation

to the holders of the first mortgage indebtedness of the Debtor. While the building of the Debtor and that of the grantee corporation adjoin and possess certain physical, cooperative facilities, such as a common entrance, a connecting bridge, elevator service in the adjoining building, and a heating system therein which furnishes heat to the Debtor's tenants,—the building of the Debtor is so constructed that these cooperative features are not permanently essential and, at comparatively small cost, the Debtor's building could be made self-sufficient.

Notwithstanding that the two corporations are separate legal entities, each with its own stockholders and creditors, they were treated together in such fashion that, as the result of correlated plans of reorganization, the corporation owning the adjoining piece obtains the conveyance of the Debtor's property in consideration of the delivery of $222,750.00 par value of the first mortgage bonds of the grantee corporation, out of a total issue of $668,250.00, and twenty-five per cent. of the capital stock of the grantee, all of which bonds and stock go to the holders of the first mortgage indebtedness of the Debtor.

No provision is made for the protection of the second and third mortgage creditors and no payment to them contemplated, the court contenting itself with the finding that by reason of a present, hypothetical value of the Debtor's property, resting upon opinion alone, they possessed no equity in the property and their security was, accordingly, worthless. As will be seen in the succeeding point, by their contracts which existed long before Section 77B was contemplated, these petitioners had the right to require a judicial sale. This was denied by the plan. They had the right to bid at such sale. This opportunity was likewise eliminated. Above all, they had the continuing and substantive right to redeem from judicial sale,

under the pre-existing law of the State of Illinois for fifteen months after any such sale should take place. This right was forever cut off by the approved plan.

It may be observed, in passing, that the wide difference in views of the experts as to fair cash "market" value, when there is no market to furnish a standard of comparison, indicates, if anything, the inevitably inconclusive and unsatisfactory nature of partisan opinions.

What the District Court neglected to observe was that if the Debtor's property actually had the low value ascribed to it by the "depression experts", the price paid by a successful bidder at foreclosure or at any other liquidation sale would be the same low price at which petitioners could redeem had their right so to do been recognized.

How petitioners were treated appears from the order confirming the plan. The District Court found "that there is no equity over and above the $445,500.00 principal amount of Carlson Annex Bonds outstanding * * *; that the Debtor is accordingly insolvent; that the stockholders are not entitled to participate in the plan and that their acceptance * * * is not a prerequisite to the confirmation of the plan" (R. 14, 15).

The court further found that, based upon the evidence and testimony concerning the value of the property, the court appraised the claims allowed in Classes 3 and 4 (petitioners' claims as second and third mortgage creditors), to be of no value, there being no equity in the property and "accordingly no securities, cash or any other thing of value shall be distributed under the plan in respect of any of the claims allowed in Classes 3 and 4, and the acceptance of the plan by the holders of such claims is not a prerequisite to the confirmation of the Plan (R. 14, 15).

The court then made the following surprising finding:

> "The court further finds that the foregoing method of treatment of the holders of claims in Classes 3 and 4 provides adequate protection for realization of the holders thereof of the value thereof under and consistent with the circumstances of the case, the same being of no value" (R. 15).

The erroneous assumption by the District Court that the alleged, temporary, sale value of property is the sole measure of property rights, disregarding the substantive, continuing right to redeem and the other rights of the petitioners, may thus be plainly seen.

Therefore, on this branch of the controversy, the question is can the holders of junior mortgage indebtednesses, recognized as valid claimants in specified classes, be wholly disregarded and their rights eliminated from beneficial participation in a plan of reorganization without their consent, without compensation, and without any provision for their protection?

This question is answered by the Act itself.

That Section 77B of the Bankruptcy Act requires the consent of two-thirds in amount of each class of creditors, or in the absence thereof, compensation or adequate protection for each of such classes, plainly appears from the language of the statute itself. Subdivision (b) of Clause 5 is as follows:

> "A plan of reorganization within the meaning of this Section shall include provisions for modifying or altering the rights of creditors generally, or any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * shall provide in respect of each class of creditors of which less than two-thirds in amount shall ac-

cept such plan (unless the claims of such class of creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens, is dealt with by the plan, as provided in the plan

(a) By the transfer or sale of such property subject to such interests, claims, or liens, or by the retention of such property by the debtor subject to such interests, claims, or liens, or

(b) By a sale free of such interests, claims, or liens at not less than a fair upset price and the transfer of such interests, claims, or liens to the proceeds of such sale; or

(c) By appraisal and payment either in cash of the value either of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted; or

(d) By such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."

Dissecting this provision, we find:

That a plan of reorganization may be adopted and approved which may modify or alter rights of creditors generally or any class of them, provided, however,

(1) That two-thirds of each class of creditors accept such plan.

(2) That such acceptance is unnecessary where the creditors of a given class are not affected.

(3) That such acceptance is unnecessary when the plan makes provision for the payment of their claims in cash in full, and

(4) That such acceptance is unnecessary if the plan provide adequate protection for the realization of the value of the interests, claims or liens dealt with by the plan.

Since petitioners who are the holders of all of the secured claims in classes 3 and 4 are entirely wiped out, it cannot be said that their interests are not affected. If, then, classes of claims be affected, and if payment in cash is not provided for, then, in the absence of consent, the ensuing language of the law becomes applicable which makes specific the requirement that *adequate protection* be accorded for the realization of such claims and interests and describing the means and methods of affording such protection.

None of these methods was adopted for the protection of the interests of those of the petitioners here who hold junior securities. There was no transfer or sale subject to their interests. There was no retention by the debtor of the property, subject to their interests. There was no sale at a fair, upset price and a transfer of the claims to the proceeds of the sale. There was no appraisal of the interests and claims of these petitioners and, obviously, this could not have been done as it would have involved placing a value on the rights of the petitioners to bid at the sale of the property and to redeem at the sale price for a period of fifteen months after the sale in the event that the property had been bid in by others. The only appraisal that was made by the court involved the valuation of the debtor's property as a whole, and in so doing the court gave to it "a foreclosure price".

In passing, it may be observed that reorganization under Section 77B, or by any other means, contemplates continued existence, continued operation, continued interests, even if altered or modified. A sale of all of the assets of a business, lock, stock and barrel, is not reorganization but liquidation in the strictest sense. It was upon the *liquidation theory* that the District Court valued the property of the debtor.

As was said in *Warner Brothers Pictures* v. *Lawton-Byrns-Bruner Ins. Agency Co.*, 79 Fed. (2nd) 804, 817 (C. C. A. 8th):

> "However, the foreclosure sales prices are by no means measures of the values of the properties for corporation purposes. Prices at foreclosure sales are notoriously under actual values (unless the property sold has a free open market value, as listed securities, grain, live stock, etc.). Such dispositions are forced sales. It is this forced sale value which is in mind when adequacy of bids at foreclosure is considered. It is the actual fair value at a free sale that is in mind when considering the value of property used for payment of corporate stock and bonds issued."

So, in the case at bar, the actual fair value at a free sale should have been the subject matter of the court's consideration since the property of the debtor was conveyed to the grantee and payment made in bonds of the grantee corporation. Under the announced decisions of the United States Courts inferior to the Supreme Court, it would seem that the judges are of the prevailing opinion that Section 77-B requires adequate protection or compensation or, in their absence, consent.

In the matter of *Hotel Charles Co.,* 12 Fed. Supp. 734, 736, (D. C. Mass.) Judge Brewster said:

> "If any creditor claims a lien upon the property affected by the plan of reorganization and he does not belong to a class of duly assenting creditors, the plan cannot be confirmed unless it provides *adequate protection* for the realization by the creditor of the value of his interest or lien in or upon the property."

The Circuit Court of Appeals of the Second Circuit in *In Re Murel Holding Corporation,* 75 Fed. (2nd) 941, speaking through Judge Hand who rendered the opinion said at page 942:

> "Normally it was expected that consents should be obtained. If they were not, the plan must 'provide adequate protection for the realization by them' the dissenting class, 'of the full value of their interest, claims or liens.' This may be done in four ways: (a) The liens may be merely kept in *statu quo.* (b) The property may be sold free and clear and the liens attached to the proceeds. (c) The value of the liens may be appraised and paid, or, if the objectors prefer, the same course might be taken with any new securities. (d) The last is not, properly speaking a 'method' at all; it merely gives power generally to the judge 'equitably and fairly' to 'provide such protection' * * * It is plain 'adequate protection' must be *completely compensatory.*"

Going to the other end of the continent, the Circuit Court of Appeals of the Ninth Circuit in *Francisco Building Corporation, Ltd. v. Battson,* 83 Fed. (2nd) 93 (C. C. A. 9th) completely approved the preceding opinion by Judge

Hand in a case where it was contended that it was unnecessary to secure the consent of bondholders and creditors because the proposed plan "came under Section 77-B of the Bankruptcy Act".

If the statute be construed as authorizing the erasure of rights of second and third mortgage bondholders, without their consent and without compensation or protection, then, in principle, rights of first mortgage bondholders may be similarly, and without their consent, adversely affected. While the rights of holders of junior securities are subject, in material respects, to the rights of creditors who are senior to them, such junior holders, nevertheless, do possess rights which are in no manner subject to, or eliminated by, the presence of an antecedent first mortgage. The first mortgagee cannot successfully object to the request of junior mortgage bondholders to have a public sale, nor can such first mortgagee deny the rights of creditors inferior to him to bid at such sale. Certainly the important property right to redeem becomes solidified when the foreclosure by the first mortgagee reaches the final result of a sale. To deny to whole classes of creditors rights which are not in any manner affected by the presence of a senior mortgage, and to hold that Section 77-B permits such denial, is to give to the Statute an unconstitutional interpretation refuted by the language of the Act itself.

In *Tennessee Publishing Co.* v. *American National Bank*, 81 Fed. (2nd) 463, (C. C. A. 6th) the Court said at page 468:

> "We are here concerned only with the validity of a clause which provides for adjustment of debts without the consent of creditors. It has long been settled that provisions in bankruptcy statutes authorizing compositions have never been held to invalidate

them. This is because a composition is a matter of agreement between the bankrupt and his creditors as a class, with the will of the majority imposed upon the minority. *In re Lane* (D. C.) 125 F. 772, 773; *Cumberland Glass Mfg. Co.* v. *DeWitt*, 237 U. S. 447, 452, 35 S. Ct. 636, 59 L. Ed. 1042.

"We confine ourselves to the provisions of subsection (b) (5), which outline a method for adjustment of claims of non-assenting creditors, and inquire as to their validity in the light of the due process clause. Upon this issue we view the decision of the Supreme Court in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106, controlling. Here, under Tennessee law, as there under Kentucky law, the lien holders had the right under their contract to retain the lien until the indebtedness secured was paid, the right to realize upon the security by a judicial public sale, the right to determine when such sale should be held, subject only to the discretion of the court, the right to protect their interest in the property by bidding at such sale, the right to have the mortgaged property devoted primarily to the satisfaction of the debt; and the right to control the property meanwhile during the period of default, subject only to the discretion of the court, and to have the rents and profits during such period applied to the satisfaction of the debt. These rights are substantive property rights, and any invasion of them under the authority of the present statute is as clearly violative of the due process clause of the Fifth Amendment as it was in the *Radford* Case."

By all processes of logical reasoning, this court, in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S.

555 rendered an opinion, the inevitable result of which is to confirm petitioners' contentions. There this court held the Frazier-Lemke Act unconstitutional because it proposed to deny property rights under a mortgage existing prior to the enactment of the statute. As the court said at page 589:

> "Because the act is retroactive in terms and as here applied purports to take away rights of the mortgagee in specific property, another provision of the Constitution is controlling.
>
> "The Bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment."

At page 589 of the opinion the Court said:

> "But the effect of the act here complained of * * * is the taking of substantive rights in specific property acquired * * * prior to the act."

Unless it is possible to say, therefore, that the rights of junior security holders are dependent wholly upon a temporary value based upon opinion and found by the court and unless the substantive, although not monetary, rights to require a public sale, to be permitted to bid thereat, and to redeem, are regarded as of no legal significance, it must follow with mathematical inevitability that any attempt to disregard and destroy such rights is an invalid exercise of governmental power. If a statute makes such attempt it is unconstitutional, and if a court by its order produces the same result under a statute which does not authorize it, its order is invalid. In the one case it is a legislative, and in the other a judicial, invasion of private rights.

Whether or not the right to redeem, for example, be a substantive right and, as such, indestructible under the provisions of any subsequently enacted legislation depends upon the law of the State of Illinois. As was said by Mr. Justice Brandeis in the *Radford* case at page 590:

> "In order to determine whether rights of that nature have been taken, we must ascertain what the mortgagee's rights were before the passage of the act. We turn, therefore, first to the law of the state."

This brings the present discussion to the consideration of the nature and inviolability of the rights of petitioners which are in no manner subject to the rights of creditors senior to them.

II.

The rights of junior lien holders, acquired prior to the enactment of Section 77-B, including the right to insist upon a public sale, the right to bid at such sale, and the right to redeem within fifteen months after a sale to a successful bidder are, under the law of the State of Illinois, property rights which cannot be disregarded or destroyed without consent.

That the rights of junior lienholders to require a public sale, to be permitted to bid thereat and to redeem from such sale, are substantive property rights, is not open to question under the decisions of this court and of the Supreme Court of the State of Illinois.

Mr. Justice Brandeis in the *Radford* case said at page 583:

> "No bankruptcy act had undertaken to modify in the interest of either the debtor or other creditors any substantive right of the holder of a mortgage valid under federal law."

In the same case, speaking of bankruptcy acts which had expressly or impliedly authorized the marshalling of liens on property of the bankrupt and the sale of such property free of encumbrances but directing that the rights of lien holders be transferred to the proceeds of such sale, the Court said at page 584:

> "But there had been no suggestion that such a sale could be made to the prejudice of the lienor, in the interest of either the debtor or of other creditors. By the settled practice, a sale free of liens will not be ordered by the bankruptcy court if it appears that the amount of the encumbrance exceeds the value of the property. And the sale is always made so as to obtain for the property the highest possible price. No court appears ever to have authorized a sale at a price less than that which the lien creditor offered to pay for the property in cash. Thus, a sale free of liens in no way impairs any substantive right of the mortgagor; and such a sale is not analogous to the sale of the bankrupt provided for by Paragraph 7 of the Frazier-Lemke Act."

Commenting upon compositions in bankruptcy, Mr. Justice Brandeis said at page 585:

> "So far as concerns the debtor, the composition is an agreement with the creditors in lieu of a distribution of the property in bankruptcy—an agreement which 'originates in a voluntary offer by the bankrupt, and results, in the main, from voluntary acceptance by his creditors.' * * * In no case of composition is a secured claim affected except when the holder is a member of a class; and then only when the composition is desired by the requisite majority and is approved by the court. Never, so far as appears, has any com-

position affected a secured claim held by a single creditor. Compositions are comparable to the voluntary adjustment with the mortgagee provided for in Paragraph 3 of the Frazier-Lemke amendment. They are not analogous to the so-called adjustment *compelled* by paragraph 7."

Under the law of Illinois, the right to redeem is clearly set forth in its statute which provides that a mortgagor shall have the right of redemption for a period of twelve months after sale, and that judgment creditors possess a similar right for fifteen months thereafter.

The Illinois Statute upon redemption, Cahill's Illinois Revised Statutes, 1931, ch. 77, paragraph 18, provides:

> "Any defendant, his heirs, administrators, assigns, or any person interested in the premises, through or under the defendant, may, within twelve months from said sale, redeem the real estate so sold by paying to the purchaser thereof, his executors, administrators or assigns or to the sheriff or master in chancery, or other officer who sold the same, or his successor in office, for the benefit of such purchaser, his executors, administrators, or assigns, *the sum of money for which the premises were sold or bid off*, with interest thereon at the rate of six per centum per annum from the time of such sale, whereupon such sale and certificate shall be null and void."

Paragraph 20 of this Statute deals with redemption by creditors and provides:

> "If such redemption is not made, any decree or judgment creditor, his executors, administrators or assigns may, after the expiration of twelve months and within fifteen months after the sale, redeem the prem-

ises in the following manner: Such creditor, his executors, administrators or assigns may sue out an execution upon his judgment or decree, and place the same in the hands of the sheriff or other proper officer to execute the same, who shall indorse upon the back thereof a levy of the premises desired to be redeemed; and the person desiring to make such redemption shall pay to such officer the amount for which the premises to be redeemed were sold, with interest thereon at the rate of six per centum per annum from the date of the sale, for the use of the purchaser of such premises, his executors, administrators or assigns, whereupon such officer shall make and file in the office of the recorder of the county in which the premises are situated a certificate of such redemption, and shall advertise and offer the premises for sale under said execution as in other cases of sale or execution."

In *Brine* v. *The Hartford Fire Insurance Company*, 96 U. S. 627, this court held that the statute of Illinois which so allowed redemption confers a substantial right and thereby becomes a rule of property. The court said at page 636:

"The Legislature of Illinois has prescribed, as an essential element of the transfer by the courts in foreclosure suits, that there shall remain to the mortgagor the right of redemption for twelve months, and to judgment creditors a similar right for fifteen months, after the sale, before the right of the purchaser to the title becomes vested. This right, as a condition on which the title passes, is as obligatory on the Federal Courts as on the State Courts, because in both cases it is made a rule of property by the Legislature, which had the power to prescribe such a rule. • • • But there is another view of the question which

is equally forcible, and which leads to the same result. All contracts between private parties are made with reference to the law of the place where they are made or are to be performed. Their construction, validity and effect are governed by the place where they are made and are to be performed, if that be the same as it is in this case. It is, therefore, said that these laws enter into and become a part of the contract."

Again, in *Parker* v. *Dacres*, 130 U. S. 43, Mr. Justice Harlan, delivering an opinion of this court, said at page 48:

> "In many of the states the right to redeem within a prescribed time after sale under a decree of foreclosure is given, in certain cases, by statute. This right, when thus given, is a substantial one, to be recognized even in the Courts of the United States sitting in equity, because the statute constitutes a rule of property in the State that enacts it. *Brine* v. *Hartford F. Ins. Co.*, 96 U. S. 627 (ad: 858); *Hammock* v. *Farmers Loan & T. Co.*, 105 U. S. 77; 88 (26; 1111, 1115); *Mason* v. *Northwestern Mut. L. Ins. Co.*, 106 U. S. 164 (27: 130); *Conn. Mut. L. Ins. Co.* v. *Cushman*, 108 U. S. 51, 63 (27: 648, 652)."

The Supreme Court of Illinois has repeatedly confirmed the statute of redemption of its own state. Thus in *Fitch* v. *Wetherbee*, 110 Ill. 475, the court, in commenting upon the absoluteness of the right of redemption, said at page 492:

> "The right of redemption given by the statute to a decree or judgment creditor is not affected by a failure of the court to provide in its decree for the sale of real estate, with the privilege of redemption. It is the statute that gives the right of redemption, and not the decree of the court. In a case where the stat-

ute authorizes a redemption from a sale, a clause in the decree ordering the sale that declares the sale shall be absolute, will not bar that right. That portion of the decree will be regarded as inoperative, and a redemption will be allowed as in other cases. Nor does it make any difference whether the sale was conducted by an officer of the law or by one appointed by the court to perform that special duty."

Other illuminating cases upon the subject are:

Bronson v. *Kinzie,* 1 How. 311, 315.
Buszin v. *Martinowicz,* 178 Ill. App. 519, 523.
Turk v. *Mayberry,* 121 Pac. 665, 669 (Okla. 1912).

The right to redeem by paying the price bid at the foreclosure sale, continuing as it does for 15 months, gives to junior security holders a valuable option. Frequently the first mortgagee is the successful bidder, and, as frequently, he bids less than the amount of the indebtedness, as is evidenced by the well nigh invariable practice of taking deficiency decrees. Particularly valuable is the right of redemption in a rising market. Whether valuable or not from a monetary standpoint, however, it is absolute and vested and it is not for the court to put a price upon it or to declare it valueless. As was said in *Cram* v. *Cottrell,* 48 Neb. 646:

"The plaintiffs had a legal right to redeem, whether or not the exercise of that right would be profitable to them. It was for them to determine whether they should exercise the right, and not for the court to deny them the right because, in its opinion, its exercise would not be profitable."

The Circuit Court of Appeals for the Seventh Circuit, *In re Georgian Hotel Corporation,* 82 Fed. (2nd) 917, rec-

ognized that the right of subordinate creditors to redeem should be observed by the court saying in page 920:

> "While it is not likely that at the present time the subordinate creditors would have realized anything if the first mortgage had been foreclosed, these creditors would, for three months after one year following the foreclosure sale, have had a right of redemption—a right which might have been valuable. And there is the possibility that, with a substantial 'comeback' in affairs, property values may increase sufficiently to give the debtor a substantial equity in the property of which these creditors would have the benefit."

Because the right of redemption is a substantive right and constitutes a rule of property in the State of Illinois, and since this right was disregarded by the order which approved the plan of reorganization, it necessarily follows that the order of the District Court was invalid. Carrying with it, as it did, the announcement of a practice and of a construction placed upon Section 77B by the United States Courts administering such proceedings, the Circuit Court of Appeals should have permitted a complete presentation of the question by a full review of the action of the lower court.

CONCLUSION.

The debtor corporation in the instant case has not been reorganized by the plan approved by the District Court. It has, on the contrary, been sold out and wound up by compelling it to convey all of its property to another, separate, legal entity. This constitutes strict liquidation and foreclosure in the most rigorous sense. The legislative thought which induced the passage of Section 77B was not destruction and termination, but protection and continuation. It seems to contemplate settlement and reorganization by the interested parties themselves under the watchful supervision of the court. No matter what may have been the legislative philosophy which induced its passage, however, a careful examination of the provisions of the Act demonstrates that no whole class of lien claimants can be summarily eliminated under its terms. No state law, no federal law, no decision by a court which attempts to destroy acknowledged, vested and substantive property rights has ever been approved by this court, and yet, as has been seen, this is exactly the result accomplished by the decree of the District Court in confirming the plan of reorganization.

A review of the case at bar will decide whether or not such a result is possible under Section 77B and will establish a timely and needed precedent.

Respectfully submitted,

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